

DOW THEORY LETTERS INC.

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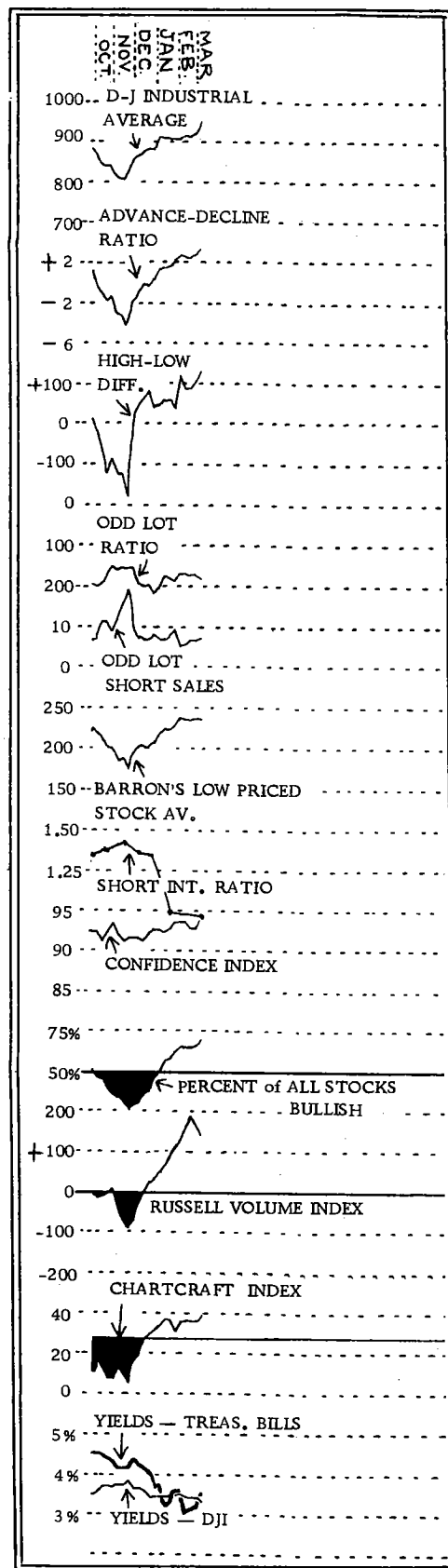
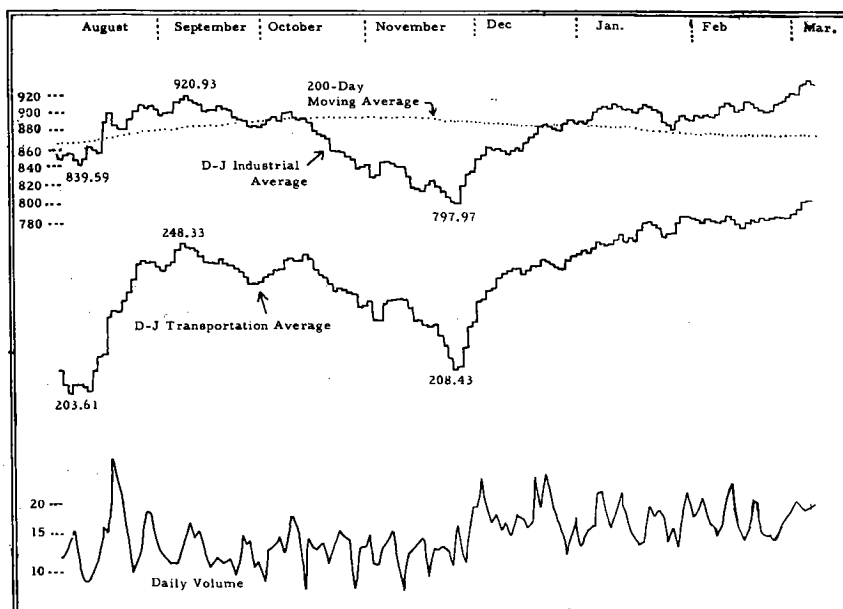
Letter 523

THE PICTURE: The current situation on Wall Street is actually one of the strangest seen in recent history. By continuing to inflate and by refusing to take steps to make the dollar convertible, the U.S. is attempting to "blackmail" its creditors into giving more and more. Europe and Japan have already realigned their currencies upward, thereby helping U.S. business in its efforts to import and export advantageously. But the dollar keeps sinking to record lows on world markets, and obviously little if anything has been solved.

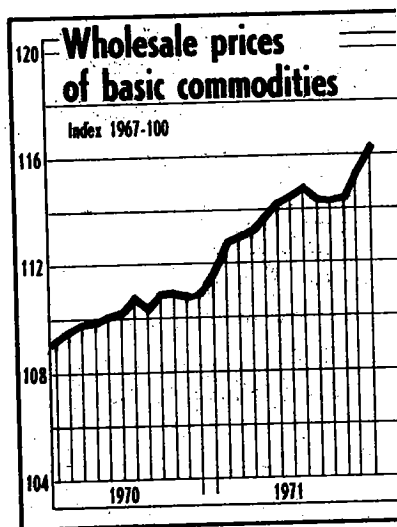
With its pitiful reserve of \$9.5 billion in gold, the U.S. is in no position to make the dollar convertible, and even worse, it is running deficits so huge that foreigners are literally giving up on the idea of the U.S. ever getting its finances in order. January's trade deficit was a fantastic \$319 million or at a deficit-rate of \$3.8 billion a year. This follows 1971's \$2 billion trade deficit (first since 1893). At the 1971-72 rate, the remaining U.S. gold reserves would not last another three years based on the trade deficit alone.

What are our foreign creditors to do with the mountains of paper which they now own, the paper which the world knows as "dollars?" As long as the dollar is non-convertible the U.S. is "saying" (and this is a form of blackmail) that its paper can be exchanged for nothing except U.S. goods. Otherwise, dollars are worthless, and the U.S.'s creditors are at the mercy of Mr. Nixon and Mr. Connally and their drive to get more and more concessions from Europe and Japan. And all the while, the value of the \$68 billion which Europe and Japan hold keeps sinking.

But there is one place where America's creditors can go with their shrinking dollars. And that place is Wall Street. So on Wall Street we may be getting buying for the worst reason in the world, a flight from a collapsing currency. Europeans and Japanese are buying stocks to get rid of unconvertible dollars, and Americans are buying stocks to hedge against their own dollars which are eroding



By Leonard H. Lempert
Special to The Christian Science Monitor



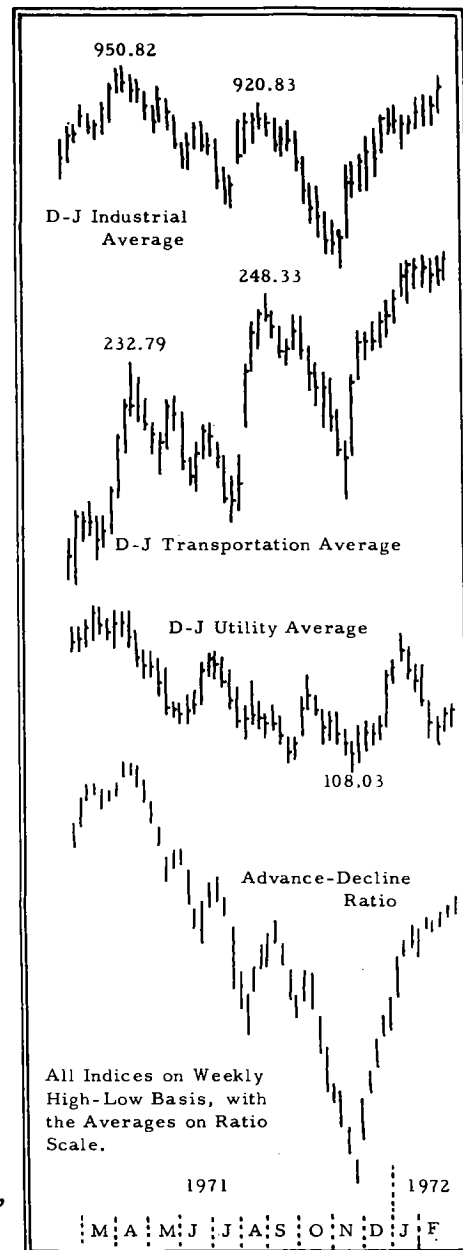
almost weekly via inflation. If there is any doubt at this time about continuing inflation, readers might study the chart of Wholesale Prices (above) which jumped .8% in January, the same advance as the December figure.

Now the best reason for buying stocks and the only factor which will keep stocks rising is a trend of expanding earnings. Along these lines, it is interesting to read the comments of Leonard Lempert (publisher of Statistical Indicators), one of the leading economic analysts in the nation. Writing for the February 24 Christian Science Monitor, Lempert laid it on the line. The fact is that despite the massive inflation, the U.S. economy continues sluggishly. To me this means one thing, bigger coming budget deficits as tax receipts to the Government fall far short of expectations. It also means further trouble for the dollar, and more upward pressure on gold. In his February 25 report, economist Eliot Janeway ends his piece by writing, "The story of the dollar will tell the story of the stock market." I agree, and the Lempert story is telling the story of the dollar.

To put the finishing touches on the whole eerie picture, the Administration is now loading a fantastic new spending program on top of the already shaky dollar, and it is obvious that foreigners are expected to finance the new onslaught by buying more dollars. The obvious conclusion is going to be a fierce confrontation between the U.S. and Europe (and Japan). The creditors will either lay down the law for the dollar or protect themselves with trade barriers, currency restrictions, and a European bloc (with its own currency) which will shield it from the greatest inflationary machine the world has ever seen.

On Wall Street the word is "speculation," and the new issues with wondrous names are coming out of the woodwork. On the weekly chart (above) we see the configuration of the four leading market indicators followed here. The picture is of two of them in violent upward trends (Industrials and Transports), while the other two are refusing to confirm. The Transports, which are the most speculative element on the chart, have burst wildly upward after consolidating in the 250-60 range for seven weeks. The Industrials are within a hair of confirming via a bettering of the April, 1971, peak of 950.82. I cannot emphasize enough the importance of the 950.82 level. A bettering of 950.82 would give a "bullish signal" for higher prices, and it would mean that the Dow has confirmed the Transportation Average by bettering all peaks since the 1968-69 highs. Conversely, a failure by the Dow to better 950.82 would suggest a picture very much like early 1969, when a major non-confirmation by the Industrial Average (despite new highs by other Averages) preceded the worst market crash since 1937.

On the other hand, a major non-confirmation now exists between all the major averages and the A-D ratio, which is still far under its April, 1971, high. And the D-J Utility Average, which led the entire market up during the whole primary bull market period of 1949 to 1965, is now in a pronounced and bearish seven-year decline.



As I see it, this market is not acting in classical bull market fashion, which means discounting the bettering business news far ahead of the events. Far from it, for today's market is being propelled upward by the Washington propaganda apparatus, and it moves on the news of the day and the endless glad tidings which issue from the Government literally hourly. In the 27 years which I have been watching Wall Street, I have never seen a market so completely dependent on spot news, Presidential stimulation and Governmental manipulations.

In a later section of this report I include a chart of the Dow going back to 1949, and here we can see that the period of the primary bear market has been extended and extended. The Government, by holding back the natural forces of correction, is creating a Frankenstein which, when it caves in, will almost surely shake the very foundations of the nation. Each month of further manipulation builds new potential strength into the bear. Finally, the whole nation will have adjusted itself as best it can to the inflation of the 1970's. "Why fight it?" will be the new American slogan (if it is not already). With that sort of psychology operating, the implications of a major crash and collapse will be far worse than anything which could have happened during the period of say 1966 to 1970.

Of great interest to me at this juncture is the rash of new soothsayers and market services which have suddenly sprung like Athena, full blown from the head of Zeus. I receive a great number of stock market advisory services here, and I am always amused to note that the bulk of the brilliance and action seems to appear following or near the top of a long advance. Advisory advertising abounds on the pages of Barron's and the New York Times, each pointing to the extraordinary record of this or that service during the last year. Others allude to the fact that their recommendations rose 70% while the Dow was only able to gain 9%.

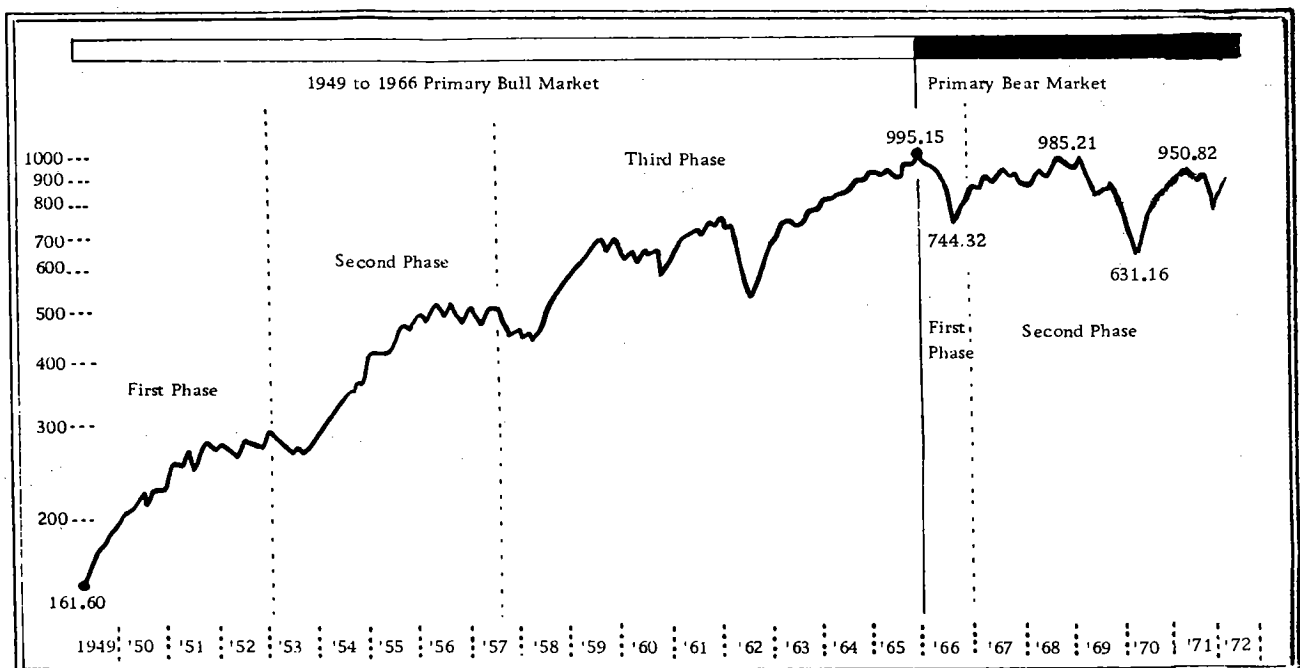
This is the kind of psychology which is always aimed at the public, at subscription gathering "while the fire is hot." Then, when the next major decline occurs and the clients are battered and the bank accounts diminished, there is the familiar "sound of silence." Together, of course, with a scattering of apologies.

* * * *

I want to draw subscribers' attentions to one important area, and that is the yield on the 91-day Treasury bills, which are the most important of all short-term obligations and the bellwether-gauge of short term interest rates. Glancing at the bottom of the long page 1 chart, note that the 91-day bills have just hit the 3.5% yield zone, thereby reversing their downtrend. In so doing, they now yield more than the 3.3% of the Dow Industrials. Rising Treasury bill yields provide rough competition for a high-priced stock market. Watch the bill yields from this point on.

PERSPECTIVE: The accompanying chart, drawn to semi-logarithmic scale (which shows percentages of advance or decline), covers the movements of the D-J Industrial Average from 1949 to the present.

The primary bull market of 1949 to 1966 is shown with its three psychological phases labeled. The first phase was the rise from the depressed levels of the preceding bear market. This lasted until 1953. The second phase represented the market's discounting of improving business and a better political and social climate for equities in general. The second psychological phase lasted until 1957. The extraordinary third phase of the bull market took the Dow from the 1957 low of 419.79 to a final peak in February,



Page 4 1966, of 995.15. This was the longest, most complex and most speculative third phase in market history. In duration it exceeded the times span of both the first and second phases of the bull market, and this was undoubtedly due to the Governments persistent "pump-priming" and manipulations. That pump-priming led the way to the strange market action since the bull market peak.

In 1966 the bull market ended, and the first phase of the bear market came suddenly and unexpectedly. Within a matter of months the Dow had broken from its 995.15 peak to a 1966 low of 744.32. The Government's inflationary and expansionary forces were turned on full blast, and under this kind of stimulus the Dow rose to a 1968 high of 985.21, halting just 10 points below the 1966 high. A second and much more crushing decline came during 1969 and 1970, and by May of 1970 the Dow had retreated to a low of 631.16.

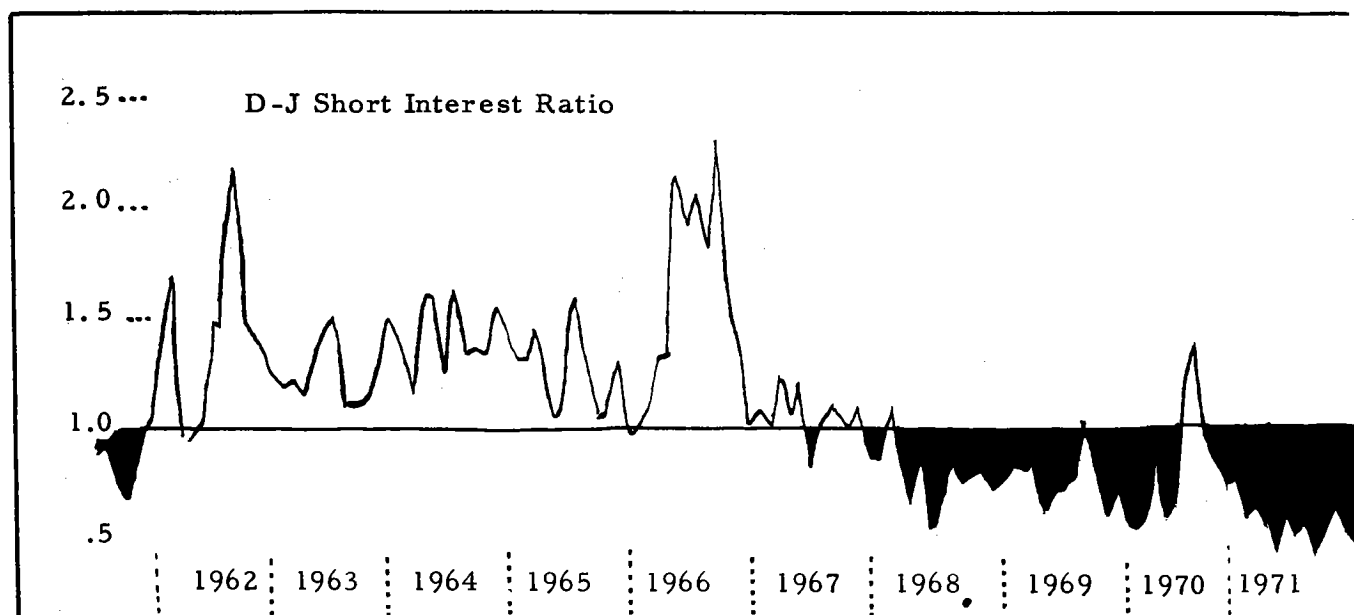
Again the money spigots were opened and every effort was utilized by the Government to counteract the bear. By April, 1971, the Dow had climbed to 950.82. A two-step decline then battered the Dow down to 797.97 on November 23, 1971, and from that point the latest advance got underway. The current rise can best be described as the "all brakes off" advance, since the Government, in the face of a devalued, unconvertible dollar (which was hitting new lows throughout the world) continued to inflate and expand the money supply. All stops were taken off as America neared the 1972 elections.

There is no question about it. The action of the market following the 744.32 low of 1966 was as complex and exotic as any seen in the history of the Averages. Classically, the second phase in both bull and bear markets is the deceptive phase, but the second phase of the bear market which began in 1966 (see chart) is out to set records. The reasons are obvious enough. For we now have a Government which will stop at nothing to gain its ends. Its foreign creditors cowed, its domestic monetary critics bewildered, its citizens confused and saving their pay at the highest rate in decades, the Administration has reversed the conservative platform it originally was elected on and became the biggest deficit-builder in peacetime U.S. history.

In the face of the fantastic Government machinations, the Dow Industrials have literally been "floated up" towards the 1971 high of 950.82 on a sea of red ink. It has taken the greatest Exchange volume in history to accomplish this, and as of this writing there have been no less than 15 trading days of over 20 million shares in 1972, a record for any three-month period in stock market annals (and the third month, March, is just starting). The Administration must be convinced that it is accomplishing its purposes, to produce at all costs a booming stock market and economy by November election time. The plan is clear. The full story, however, has not yet been told.

Primary bear markets have a habit of hitting their yearly peaks during or around the first quarter of each year. Then, as the picture becomes clearer, the market begins to discount the troubles it sees which are calculated to surface during the remainder of the year. Therefore, it would not surprise me to see the high for 1972 recorded during the current month of March, with large and powerful investors distributing in anticipation of the possible "trouble and moments of truth after the Election."

DOW SHORT INTEREST: With the short interest dropping to 559 thousand from 571 thousand in the 30 Dow Industrial stocks, and with average volume for those 30 stocks slightly lower, the Dow short interest ratio (DSIR) rose minutely to .45 in the mid-February period from the preceding mid-January period.



The DSIR held under the critical 1.0 level for all of 1971, the first time in history that this indicator has spent a solid year under the 1.0 level. With the December, 1971, DSIR reading at .50, the January, 1972, reading at .44 and the February reading at .45, the three-month average is now at an all-time record low of .46. Thus this indicator is saying that in terms of average volume in the 30 Dow Industrial stocks, the short interest in those 30 stocks is at dangerously low levels. Another way of putting it is that there is little technical support for the Dow Industrials in terms of their short interest.

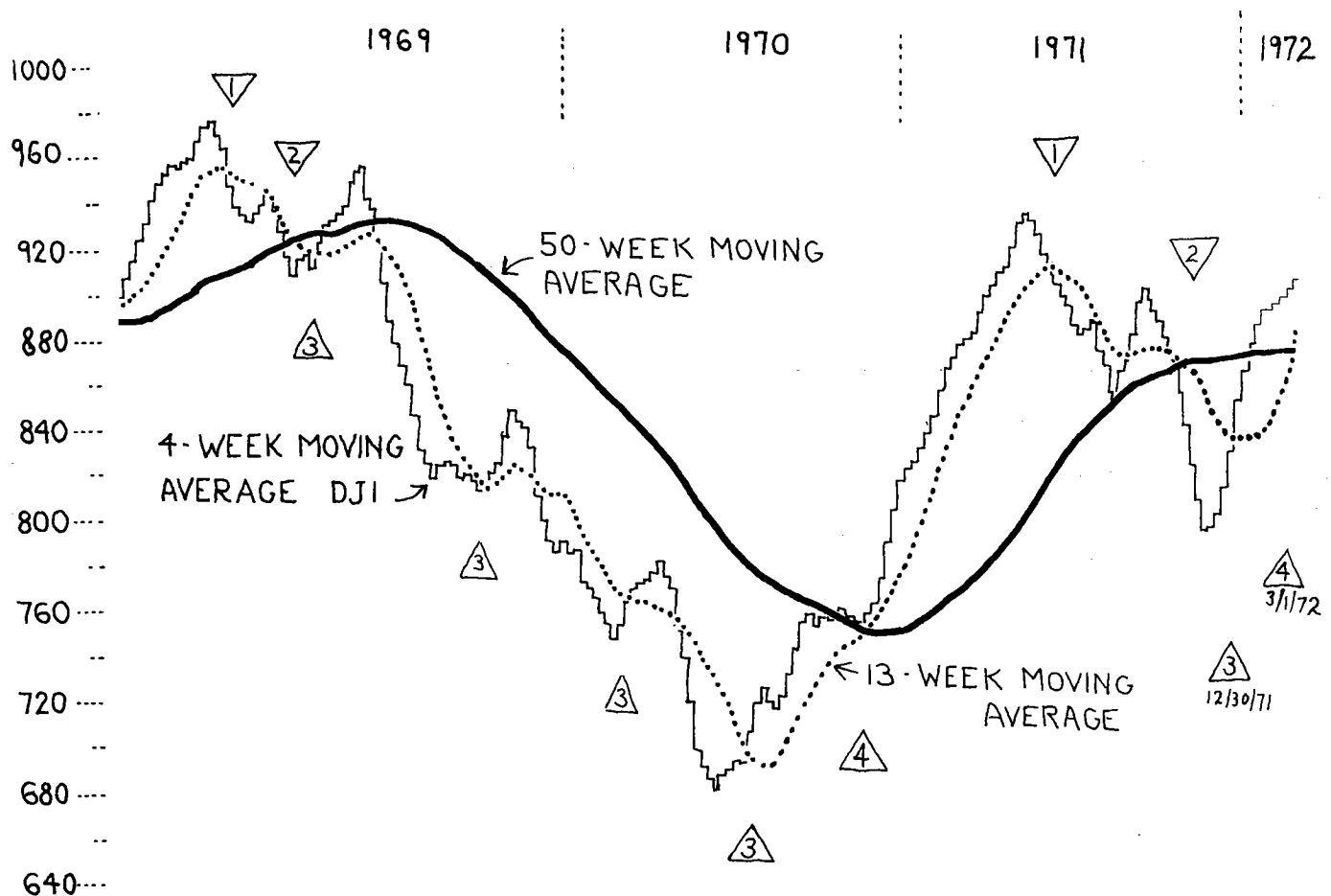
Remember, the DSIR is basically a study in psychology. In order to be bullish in the face of today's huge trading volume, there would have to be enough skepticism to push the short interest in the 30 Dow stocks above the one million level, thereby providing a reading of 1.0 or better for the DSIR. The fact is, however, that Wall Street is very bullish, and people are loath to short the Dow stocks. This is the reason that there are only 559 thousand shorts in the 30 Dow Industrial stocks. The DSIR is saying that the market is skating on exceedingly thin ice.

MOVING AVERAGES: With this Letter I am up-dating the study of the three moving averages which last appeared in Letter 518. At that time (end of December) a number 3 signal had been given, which meant that the 4-week moving average of the Dow Industrials had moved above the 13-week moving average of the Dow Industrials. This was a preliminary bullish signal.

Last week a number 4 signal was given, and this indicated that the 13-week moving average had pushed above the long-term or 50-week moving average of the Dow. The violence of the upward movement can be seen by the almost straight-up angle of the 13-week moving average (dotted line), and also by the almost perpendicular rise of the 4-week moving average.

I don't want to try to "interpret" the actions of this study too much, because it is a strictly mechanical study. It can be followed "with no questions asked," or it can be used merely as a running guide to short-term, intermediate and long-term pressures on the market.

All three moving averages are now in the bullish position, with all three of them rising. If there is trouble ahead, the first signal must be a number 1 signal, which would be a plunge of the 4-week moving average below the 13-week moving average. If that occurs, it will immediately be reported here.



GOLD PICTURE: On March 7 the Finance Ministers of the European Common Market drew up plans for the first step in their long-range economic and monetary union. One of the most interesting items will be a common market currency (said to be called the Europa) which will be tied to gold and will in all probability be a hard currency.

With the plans for the Europa the U.S. is faced with the spectre of a disciplined Europe, solving its problems in a civilized and strong way, while the U.S. itself continues to trip down the primrose monetary path and as its once impregnable currency sinks to the lowest levels in history.

I am indebted to my friend John McFalls of Seattle (Value-Action Service) for this quote from Aristophanes' "The Frogs" (about 400 B.C.):

"The noble silver drachma that of old we were
So proud of, and the recent gold coins that
Rang true, clean-stamped, and worth their weight
Throughout the world, have ceased to circulate.

Instead, the purses of Athenian shoppers
Are full of shoddy silver-plated coppers
Just so, when men are needed by the nation,
The best have been withdrawn from circulation."

Many of my subscribers will accuse me of making a political commentary. I am.

* * * *

I am including an interesting chart showing Barron's Gold Average compared with the S & P broad 500 Average. As you can see, the Gold Average has caught up in a hurry. However, judging by volume in gold shares which I chart weekly (I will publish this chart soon), there is little interest in gold shares among the public or the funds. I would say that the great bulk of gold shares have been purchased by private investors, who see the writing on the wall and are quietly accumulating the golds for the crises they see ahead over the next few years.

Here are P & F charts of two leading listed (N.Y.S.E.) gold stocks, and they both appear to be in "head-and-shoulders" bottom formations. I would say that a tip-off on an upward gold share move would be a rise of American South African above 51, which would constitute a definite upside break for this stock. (Dow Theory Letters and Richard Russell may both be owners of many of the gold shares mentioned in these reports). Charts courtesy of Paflibe, 18 E. 41st St., N.Y.C. 10017.

